VZCZCXYZ0043
RR RUEHWEB

DE RUEHAK #0682/01 0851429
ZNR UUUUU ZZH
R 261429Z MAR 07
FM AMEMBASSY ANKARA
TO RUEHC/SECSTATE WASHDC 1460
RUEATRS/DEPT OF TREASURY WASHDC
INFO RUEHIT/AMCONSUL ISTANBUL 2392

UNCLAS ANKARA 000682

SIPDIS

SIPDIS

TREASURY FOR INTERNATIONAL AFFAIRS - JROSE

E.O. 12958: N/A
TAGS: EFIN TU
SUBJECT: ELECTRICITY PRICE ISSUE HOLDING UP IMF PROGRAM

REF: ANKARA 591 AND PREVIOUS

¶1. (SBU) Summary: The IMF mission left Ankara March 21 without reaching agreement on the terms of the Sixth Review. Both sides, however, were at pains to explain that agreement was reached in every area but one: what to do about the fiscal impact of constant electricity prices charged by state-owned energy companies, despite higher fuel costs. The two sides are working to reach agreement through cost cuts since the Government seems determined not to raise electricity prices before elections. Agreement was reached on spending cuts to make up for overspending in 2006 and subsequent populist measures that could hurt 2007 fiscal balances. The Government persuaded IMF staff that it was unrealistic to try to submit pass social security reform legislation before the elections. End Summary.

IMF Leaves Without a Deal

¶2. (SBU) Following the more collegial Article IV discussions (reftel) the IMF Mission embarked on negotiations on the Sixth Review under its Standby Program. Ultimately, the Fund mission finally left town March 21 without having reached agreement with the authorities -- a relatively rare occurrence for IMF missions here. In the absence of an agreement, the customary press conference was not held, but both sides issued public statements to the effect that broad agreement had been reached in all areas except state energy company finances. Minister Babacan followed up with an appearance before the press March 22. We met with IMF and Turkish Treasury officials to get a fuller picture.

Compensating Fiscal Measures

¶3. (SBU) Thanks largely to one-off revenues, in 2006 the Government overperformed on the centerpiece primary surplus target of 6.5% of GDP. On the spending side, however, the Government violated its agreement with the Fund not to spend any of the overperformance and exceeded explicit spending caps. To compensate for this overspending, it was agreed that 0.3% of GDP of spending cuts would be enacted in 2007. The outlook for 2007 performance has also been clouded by a series of measures, opposed by the IMF, such as expanding the number of provinces eligible for investment incentives, increasing pension payments more than projected, and cutting special consumption taxes on vehicles. Another 0.3% of GDP in cuts was therefore agreed by the two sides to bring projected fiscal balances back in line with the 2007 budget. The cuts are to expected to be spread across the budget, however, the public investment budget is likely to take the

biggest hit.

Health Care Spending Still Problematic

¶4. (SBU) As during all recent IMF reviews, Fund staff was concerned about controlling the growth of health spending. The IMF's fear is that spending will exceed the 2007 budgeted allocation due to insufficient controls. In the end, an understanding was reached after a 14-hour overnight meeting with four ministers including the Health Minister Recep Akdag. On the one hand, the Government, including the Health Minister personally, committed not to exceed the budget. To give credibility to this commitment, additional work is being done on mechanisms to better control spending by hospitals. Among these are monitoring of individual invoices submitted by hospitals to the Social Security Administration, instituting partial reimbursement to hospitals when they go over hospital-specific spending limits, auditing 5-10% of bills submitted, and keeping bonus payments to doctors at the 2006 level.

State Energy Company Finances

¶5. (SBU) Beyond the central government, achievement of the overall public sector's primary surplus target could be threatened by financial weakness at state energy companies, particularly the electricity distribution company TEDAS and the gas company BOTAS. The root of these companies' financial problems is the Government's refusal to raise electricity prices which have remained constant since 2002 despite a doubling of world oil prices. Although Babacan and some other minsiters agreed in principle to electricity price increases in November, the politics of increasing electricity prices in an election year have trumped other considerations. In the end, this was the only area in which the mission and the Government could not reach agreement. Discussions are continuing, with the IMF pushing both for electricity price increases and for a structural fix to take pricing decisions out of the hands of politicians, by passing a law with an automatic formula. In the short run, however, Babacan stated publicly that the Government will not agree to price increases, and will seek to make up for the state company's financial weakness through spending cuts or efficiencies, which the IMF told us they may have to accept, at least until after the elections. If cuts at the companies themselves are insufficient, the IMF will demand cuts elsewhere in the public sector.

Social Security Reform Postponed

¶6. (SBU) Following the Constitutional Court's invalidation of the Social Security reform law, the Government had announced it would submit revised legislation by July 1. When the IMF mission came, however, the Government argued that trying to push through legislation by July 1 was unrealistic and ran the risk that parliamentarians -- even from the ruling party -- would water down the reform under electoral pressure. There is also a very narrow window in which the legislation could be considered: parliament will be entirely focused on presidential elections from April 15 to May 15, after which parliamentarians will be distracted by upcoming parliamentary elections, widely expected to be called earlier than November.

¶7. (SBU) In the end, the IMF team was persuaded by the Government's argument. The IMF believes the Government is committed to the reform since they have passed it twice. The Government's plan is to issue a new white paper, with several options that come close to achieving the savings in the original plan but still have a good chance of being acceptable to the Constitutional Court. After consultation with labor unions and other stakeholders, the Government

would submit legislation, but only after elections.

Other Structural Reforms

¶8. (SBU) The IMF was frustrated with the Government's decision to privatize Halk Bank in two stages, with a minority share IPO first, since the goal of privatization is to move control to the private sector rather than just raise money. IMF officials told us that the outside advisors had recommended a block sale up front as the preferred option. The one advantage of the IPO-first strategy that the IMF acknowledged was that it would set a market price for Halk Bank, thereby undermining critics who might claim that the Government was selling Halk at a fire sale price.

¶9. (SBU) President Sezer's veto of the second stage of the personal income tax reform was because of a clause on tobacco and alcohol taxes that was of no importance to the IMF. The Government has removed the offending clause and will reportedly re-submit the legislation in the coming week or two.

¶10. (SBU) The IMF's Financial Sector Assessment team was also in Ankara to wrap up its work. The FSAP is expected to go to the board along with the Article IV document, either simultaneous to the Sixth Review or sooner, if the Sixth Review document is not ready. A Turkish Treasury official told us there were no significant concerns about the banking sector raised in the FSAP and the IMF officials did not mention it. This tracks with a widespread view that the banking sector has strengthened considerably over the last two or three years.

Board Vote in May?

¶11. (SBU) The plan now is for a Letter of Intent Signature in early May and a board vote in late May. Given the necessity of Government follow-up actions and the track record, we would be inclined to bet this will slip a bit, especially in the context of presidential elections. In the end, however, the IMF and the Government both have a big stake in keeping the program alive.

Visit Ankara's Classified Web Site at
http://www.state.sgov.gov/p/eur/ankara/

MCELDOWNEY